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USWEST

Glenn Brown
Executive Director-
Public Policy

September 20, 1996

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street N.W., Room 222
Washington, D.C. 20554

RE: CC Docket 96-45

Dear Mr. Caton:

On September 20, 1996 the undersigned met with Regina Keeney, Chief, Pam Szymczak, Jeanine Poltronieri and Tim Peterson, all of the Common Carrier Bureau, on Universal Service. The attached charts were used during this discussion.

In accordance with Commissioner Rule 1.1206(a)(1), two copies of the letter are being filed with you for inclusion in the public record. Acknowledgment and date of receipt are requested. A copy of this transmittal letter is provided for this purpose. Please contact me if you have questions.

Sincerely,



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UNIVERSAL SERVICE

AGENDA

1. Impact of Interconnection Order
2. Three “whys”
 - Why Census Block Groups
 - Why Proxy Models
 - Why End User Surcharge

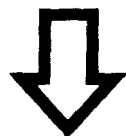
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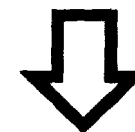
Universal Service

Low Income Programs
Lifeline/Linkup
Telephone Relay System
Explicit High Cost Fund
Funding for Unserved
Schools, Libraries
Rural Health Care

Implicit Support to All
Residential Customers
Rate Averaging
Interproduct Support
• *Access/Toll to Local*
• *Business to Res Local*
Other - Capital Rec, Directory



Today - @\$1B/ Tomorrow ?



\$\$@3 - 19B

***Low Income, TRS, High Cost, Unserved, Education, Rural Health Care and
Implicit Support to Residential customers all come under the Universal
Service Umbrella.***

THE RECENT INTERCONNECTION ORDER COMPLICATES THE UNIVERSAL SERVICE PROCESS

1. Pricing of Unbundled Elements

- **TELRIC**
- **“Default Proxy” Prices**
- **Hatfield Study/Fantasy Networks**

2. Use of Unbundled Elements

- **Any Combination of Elements**

3. Joint Marketing Restrictions

- **Joint Marketing of “Resold” Services Restricted**
- **No Restriction on Unbundled Elements**

As a result of this decision, implicit support from access and vertical services will be lost much faster than originally thought

Actions Necessary to Preserve Universal Service

1. **Rate Rebalance**
 - ✓ Pricing flexibility - Allow competitors and incumbents to compete
 - ✓ Prices more closely aligned with costs and market conditions - Residence rates must be allowed to cover costs.
2. **Properly Structure Interconnection Charges**
 - ✓ Interconnectors must pay their fair share of common, shared and universal service support costs.
3. **Target Support**
 - ✓ Low Income
 - ✓ High Cost
 - ✓ TRS
4. **Restructure Funding**
 - ✓ Make all support explicit
 - ✓ Reform existing support mechanisms where necessary
5. **Establish Transitional Universal Service Fund Until Rate Rebalancing Achieved**

Need to Target High Cost Support to Very Small Geographic Units

- Rural Community wire center with 1,000 Lines
 - 800 Lines in Town at \$20/Mo. Average Cost
 - 200 Lines on Outlying Farms at \$200/Mo.
 - Funding Benchmark at \$30/Mo
- Universal Service Fund Calculation
 - Wire Center:
 - Average Cost: 800 Lines X \$20/Line = \$16,000
 - 200 Lines X \$200/Line = \$40,000
 - Total Cost = \$56,000
 - Average Cost = \$56/Line/Mo
 - Universal Service Funding = \$56 - \$30 = \$26/Line/Mo

Census Block Targeting:

Town Customers: Cost \$20/Month - No Benchmark Funding

Farm Customer: \$200 Cost - \$30 Benchmark = \$170/line

U S WEST's Census Block Model better targets high cost funding in a competitive environment. Wire Center targeting could result in new entrants receiving \$6 more than cost for providing service in towns. Also there would be no incentive for new entrants to provide service to the \$200 outlying farm customers because they would only receive \$26 in high cost funds resulting in a \$144 support shortfall.

Proxy Model Evolution

- **U S WEST High Cost Model**
 - 1994
 - Distance & Density
- **Benchmark Cost Model**
 - 1995
 - U S WEST, MCI, NYNEX, Sprint
 - Multiple Cost Factors
 - Relative Cost Of Basic Service
- **Benchmark Cost Model 2**
 - 1996
 - U S WEST, Sprint
 - More Refined Cost Elements
 - Total Cost of Basic Service
- **Best Of Breed Process**
 - Combine Best Aspects
 - Benchmark Cost Model 2
 - Cost Proxy Model (PacTel)
 - Multiple Large Companies

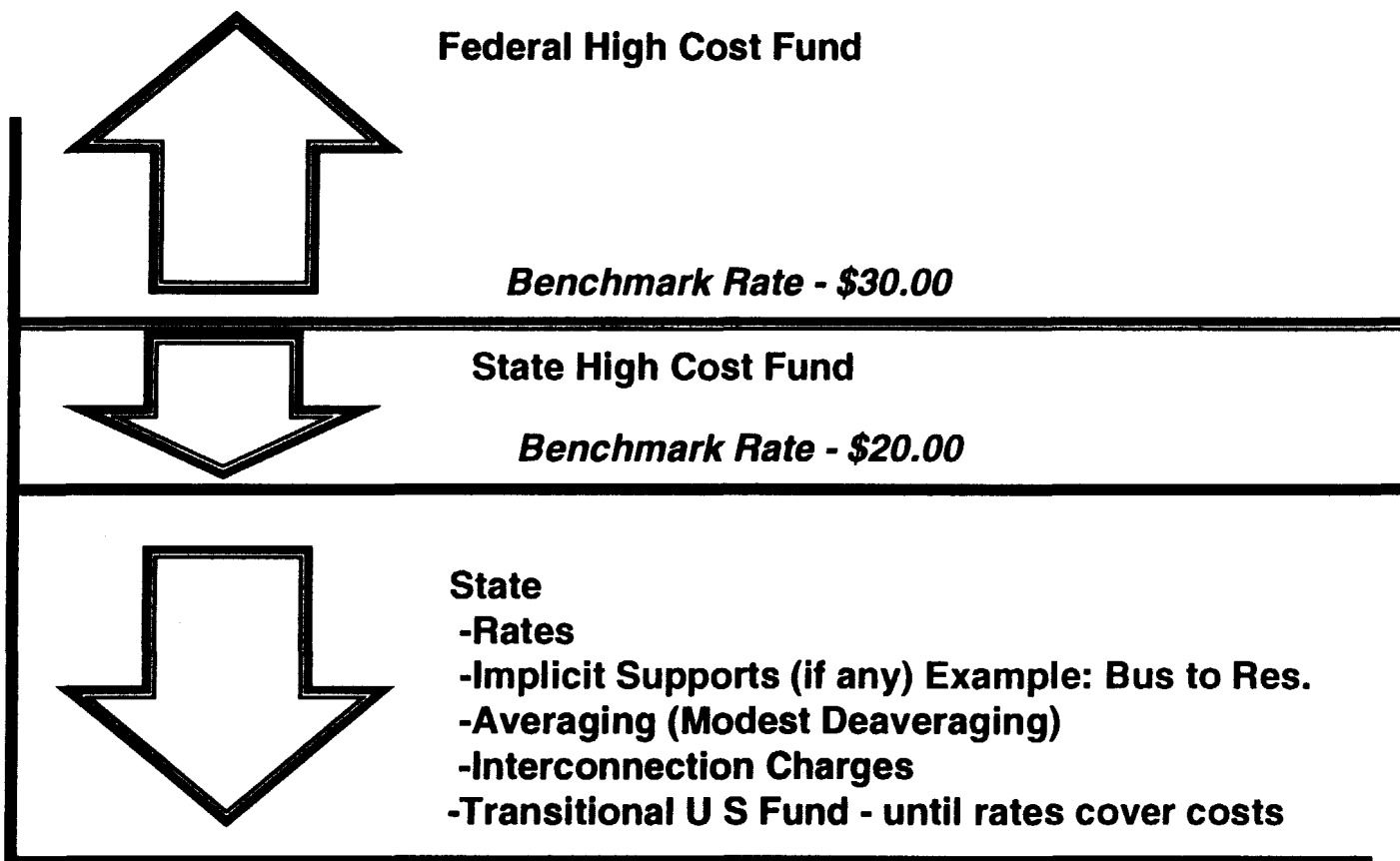
Improvements In BCM2 Over BCM1

- **More Accurate Rural Costs**
 - **Define Populated Areas**
 - **Wireless Alternative Considered**
- **More Accurate Urban Costs**
 - **Include Missing Network Elements**
 - **Include Urban Cost Structures**
 - **More Accurate Distribution Algorithm**
 - **Business Lines Included**
- **More Accurate Expense Calculation**
 - **Investment Related**
 - **Line Related**
- **50 States, DC, Puerto Rico, Virgin Islands, Micronesia**

Projected Fund Size From BCM2

Funding Benchmark	Fund
\$20/Mo.	\$14.7B
30	7.4
40	4.3
50	2.4
60	1.3
70	.8
80	.5

Benchmark Concept



Incumbent LECs are entitled to full recovery of costs incurred to meet historical and current universal service obligations. This recovery should be through a combination of federal and state price levels and explicit high cost funds.

Funding Should Be Broadly Based

- ✓ **Broad base will reduce disparities among competitors**
- ✓ **A USF charge should apply to services or products provided by, among others, the local exchange companies; interexchange carriers; mobile telephone and radio communications companies (including cellular, PCN, and radio common carriers); on-line services; cable companies providing telecommunications services; competitive access providers; resellers of telecommunications; telecommunications customers of private networks; etc.**

Calculation of Surcharge Example

\$15B Fund Size (High Cost and Education)

=

8.5% USF Charge

\$176.2B Total Retail Revenues

*(Source: North American Telecommunications Association
"Telecommunications Market Review and Forecast")*

***The broader the base the smaller the USF
charge***

In Their November Decision, the Joint Board Should do the Following.

- **Direct that all prices reflect the cost of providing services and, where this is not possible, that subsidies be explicit and targeted.**
- **Find that a proxy model is useful for targeting of support.**
- **Specify the aspects which would define an acceptable high cost targeting model.**
 - **Process for locating customers.**
 - **Outside plant design and costing principles.**
 - **Switch design and costing principles.**
 - **Standards for documenting model logic and the sources of cost data inputs.**
 - **Reasonableness tests to assure that model outputs are representative of costs that can be reasonably be expected in the construction of a network, and that the network is capable of providing service which meets service quality standards of state and federal regulators.**
- **Direct parties to submit cost models which conform the Joint Boards specifications.**